Tax Treatment of Thrift Savings Plan Payments to Nonresident Aliens and Their Beneficiaries

This notice summarizes tax rules that apply to Thrift Savings Plan (TSP) payments made to nonresident aliens and beneficiaries of nonresident aliens.

A **nonresident alien** is an individual who is neither a citizen nor a resident of the United States.[1] A **resident alien** is an individual who is or was a lawful permanent resident of the United States during any part of a calendar year. An alien may also be considered a U.S. resident if the individual meets the Internal Revenue Service (IRS) "substantial presence" test for a calendar year.[2] For information on residency status and the tests for residence, you may obtain IRS Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Corporations, or IRS Publication 519, U.S. Tax Guide for Aliens. You may also wish to consult with a tax advisor regarding any of the information contained in this notice.

For purposes of this notice, the following additional definitions may be helpful:

- A **participant** is a Federal employee who has an account in the TSP.
- A **beneficiary** is a person entitled to the TSP account of a deceased participant.
- **Taxable income** means an amount of money received by a participant or beneficiary from the TSP which is subject to U.S. income tax.
- **Tax withholding** is money that is withheld from a TSP distribution and paid to the IRS for payment of U.S. income tax.
- An **eligible rollover distribution** is a distribution from the TSP to a participant or spouse which is **not** (1) a payment that is calculated based on life expectancy, (2) made over a period of at least 10 years, or (3) an IRS required minimum distribution.
- An **Individual Retirement Arrangement (IRA)** is a fund held by a bank or other IRS-approved trustee or custodian which is established and maintained in the United States to hold retirement savings.
- A **transfer** occurs when you instruct the TSP to send all or part of a payment directly to an IRA, instead of issuing it directly to you.
- A **rollover** occurs when the TSP makes a distribution to you (which includes the amount of the check you receive plus the amount withheld) and you deposit any part of that distribution into an IRA within 60 days of the date you receive it.

The tax treatment of TSP payments is explained in the following questions and answers.

1. Do I owe U.S. taxes on a payment from the TSP?

A payment made by the TSP is taxable income for U.S. Federal income tax purposes in the year in which the payment is made. The Federal income tax treatment of payments from the TSP depends on two factors: the residency status of the participant when he or she was employed as a Federal employee and the residency status of the participant or beneficiary when he or she receives the payment(s) from the TSP. The Internal Revenue Code governs your tax liability and withholding responsibilities.

In general, the following rules apply:

- A **nonresident alien participant** who never worked for the U.S. Government in the United States will not be liable for U.S. income tax.
- A **nonresident alien participant** who worked for the U.S. Government in the United States may be liable for U.S. income tax. See Publication 721, U.S. Guide to Civil Service Benefits.
- A **resident alien participant** will be liable for U.S. income tax.
- A **U.S. citizen participant** will be liable for U.S. income tax.

[1] The "United States" includes the 50 states and the District of Columbia.

[2] This is commonly referred to as the "green card" test.

- A **nonresident alien beneficiary** of a nonresident alien participant will not be liable for U.S. income tax if the participant never worked for the U.S. Government in the United States.
- A **nonresident alien beneficiary** of a resident alien participant will be liable for U.S. income tax.
- A **nonresident alien beneficiary** of a U.S. citizen participant will be liable for U.S. income tax.
- A **U.S. citizen beneficiary** of a nonresident alien participant will be liable for U.S. income tax.
- A **resident alien beneficiary** of a resident alien participant will be liable for U.S. income tax.
- A **resident alien beneficiary** of a nonresident alien participant will be liable for U.S. income tax.

2. Will the TSP withhold U.S. taxes from my payments?

This depends on whether the payment you receive is subject to U.S. income tax. If the money that you receive is subject to U.S. income tax, then it is subject to withholding. In general, the only persons who do not owe U.S. taxes are nonresident alien participants and nonresident alien beneficiaries of nonresident alien participants. The TSP will not withhold any U.S. taxes if you fit into either category, and you submit the certification described below. However, if you do not submit the certification to the TSP, the TSP must withhold 30% of your payment for Federal income taxes.

To verify that no tax withholding is required on a payment you are receiving as a participant, the TSP asks that you certify under penalty of perjury that you are a nonresident alien whose contributions to the TSP were based on income earned outside the United States. If you are receiving a payment as a beneficiary, you must certify that you are a nonresident alien and that the deceased participant was also a nonresident alien whose contributions to the TSP were based on income earned outside the United States. The TSP will provide the certification form to you upon request.

3. How much tax will be withheld on payments from the TSP?

The amount withheld depends upon your status, as described below.

Participant. If you are a **nonresident alien**, your payment will not be subject to withholding for U.S. income taxes. (See question 2 above.) If you are a **U.S. citizen or a resident alien**, your payment will be subject to withholding for U.S. income taxes. When you separate, if you are a U.S. citizen or resident alien you will receive from your employing agency a tax notice, Important Tax Information About Payments From Your TSP Account, explaining the withholding rules.

Spouse Beneficiary. Special rules apply to taxable payments to a beneficiary who is the spouse of a deceased participant. If you are a spouse beneficiary who is a nonresident alien, the payment to you is considered an eligible rollover distribution and is subject to 30% withholding. A beneficiary may be entitled to a lower rate of withholding under a treaty entered into between his or her country and the United States. In that case, the beneficiary must establish that the treaty provisions allow for a lower withholding rate. In order to claim the benefit of a treaty, the beneficiary must file **with the TSP** IRS Form 1001, Ownership, Exemption, or Reduced Rate Certificate. Note: The 30% is tax withholding, not actual tax paid. You may be entitled to a refund of a portion of this amount, or you may be required to pay an additional amount, when you file your annual Federal income tax return.

- Before you receive an eligible rollover distribution, you can avoid withholding on all or any portion of your payment by asking the TSP to transfer that amount to an IRA. However, you **cannot** avoid the 30% withholding on any amount that you elect to receive directly, even if you then roll it over to an IRA.
- You may elect to have an amount withheld in addition to the 30% withholding by completing Line 3 on IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments, and submitting it to the TSP Service Office at the address provided at the end of this notice. Line 1 and Line 2 are not valid elections for this type of payment.

- There is no mandatory withholding on eligible rollover distributions that are less than $200. However, you can still elect withholding for any eligible rollover distribution of less than $200 by completing Line 3 on Form W-4P. Payments that are less than $200 are also eligible to be transferred by the TSP or rolled over to an IRA.

All Other Nonresident Alien Beneficiaries. If you are a nonresident alien beneficiary who is not a surviving spouse and the payment is taxable, the TSP will withhold 30% of the payment. If you submit Form W-4P, you may elect:

– to have no Federal income tax withheld, by completing Line 3 on Form W-4P, and filing IRS Form 1001.

– to have an amount withheld in addition to the 30%, by completing Line 3 on Form W-4P.

Note: You may not complete both Line 1 and Line 3 on Form W-4P. Line 2 on Form W-4P is not a valid election for this type of payment.

In order to claim the benefit of a treaty that establishes a lower withholding rate, you must file with the TSP IRS Form 1001.

If you attempt to waive withholding in any manner other than that described in this section, the TSP is required to withhold 30% of your distribution for Federal income taxes.

4. What other considerations apply to tax withholding?

The following information applies to all TSP payments that are subject to U.S. income tax:

Under-withholding. If you do not have enough Federal income tax withheld from your payment, you may be responsible for paying estimated tax. You may also incur penalties under the IRS estimated tax rules if your withholding and estimated tax payments are insufficient. You should be aware that the TSP does not withhold for a foreign country's income tax or for state, city, or other local income tax.

Rollovers. Distributions from the TSP are eligible for transfer or rollover to an IRA (see page 1) only if the distribution is an eligible rollover distribution which is subject to U.S. income tax. An IRA must be established and maintained in the United States.

An IRA is an Individual Retirement Arrangement, which can be either an Individual Retirement Account or an Individual Retirement Annuity (other than an endowment contract). However, you cannot transfer or roll over your payment to a "Roth" IRA (which became available January 1, 1998).

By transferring or rolling an amount over to an IRA, you can postpone paying tax on that amount until you receive the money from the IRA. The 30% Federal income tax withholding does not apply to an amount that the TSP transfers directly to an IRA; **however, it does apply to any payment made directly to you, even if you then roll it over.**

In deciding whether to choose a transfer or a rollover, you should consider the following:

- You must pay Federal income tax on any part of the payment that you do not transfer or roll over.
- Because all eligible rollover distributions of $200 or more made directly to you are subject to 30% withholding, you will have to pay tax on the amount withheld — even if you roll over the amount you receive — unless you deposit personal funds into your IRA equal to the amount withheld. (If you do this, you may receive a refund of taxes withheld, but you cannot wait until you receive a refund to complete a rollover.)

Therefore, if you do not want to use personal funds to make up the amount withheld, you should choose to have the TSP transfer the payment to your IRA directly, instead of rolling it over to your IRA yourself.

5. Can I use the 5-year or 10-year tax option?

If the payment you receive from the TSP qualifies as an **eligible lump sum distribution**, you may be able to lower the income tax you pay by using the 5-year or 10-year tax option.

An **eligible lump sum distribution** is one in which your total TSP account balance is distributed to you within one tax year (the calendar year for most taxpayers), regardless of whether this occurs in one or more payments. This means that an eligible lump sum distribution can include amounts which the TSP distributes to you in a series of monthly payments, in a subsequent payment made after your initial withdrawal, or in a taxable loan distribution — as long as all amounts in your account are distributed to you in the same tax year. However, if you transfer or roll over all or any part of your distribution, you cannot use the 5-year or 10-year tax option.

At present, if you use the **5-year tax option**, your eligible lump sum distribution is taxed as if it were paid to you over five tax years, using the tax rates for single taxpayers in effect in the year payment is made. The 5-year tax option is available if you are at least 59½ at the time you receive your distribution. (In 1996, Congress eliminated the 5-year tax option for tax years beginning after December 31, 1999.)

With the **10-year tax option**, your eligible lump sum distribution is taxed as if it were paid to you over 10 tax years, but you must use the tax rates in effect in 1986. The 10-year tax option is available only if you were age 50 before January 1, 1986.

The following rules apply to the 5-year and 10-year tax options:

- To qualify for either type of tax option, you must have been an **active participant** in the TSP for at least five years before the year in which your distribution is made. You are considered an active participant if a contribution was made to your TSP account by either you or your agency during a year.
- If you decide to use the 5-year or 10-year tax option for your TSP distribution, you must also use it for any eligible lump sum distribution, excluding IRAs, which you receive in the same tax year from any other plan maintained by an employer.
- You can use the 5-year or 10-year tax option only once in your lifetime. This means that if you use it in one tax year, you cannot use it for a distribution received from the TSP or another plan in any subsequent year.

Election of either the 5-year or 10-year tax option is made by filing IRS Form 4972, Tax on Lump Sum Distributions, with your annual income tax return.

6. Does the $5,000 death benefit exclusion apply to TSP payments?

A $5,000 death benefit exclusion is available to beneficiaries of participants who died before August 21, 1996. This $5,000 exclusion from Federal income tax applies to all amounts paid to beneficiaries of a deceased individual by that individual's employer and any employer-sponsored retirement plans. Therefore, if the participant died before August 21, 1996, and if the TSP death benefit payment to you qualifies as an eligible lump sum distribution, you may also be able to exclude from Federal income tax up to $5,000 of the amount paid to you. You should consult with the executor or administrator of the deceased participant's estate or your tax advisor to determine if all or any part of this exclusion can be applied to the payment you receive from the TSP.

7. How does the TSP report payments for U. S. income tax purposes?

The TSP will report to the IRS all payments that are made directly to you as well as all transfers made to IRAs. The TSP will also report such payments and transfers to the state in which you resided at the time the payments were made, if that state imposes an income tax.

In March of the year that follows your TSP payment, the TSP will send you Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding. This form shows the amount of the payment made to you and the amount withheld for Federal income taxes.

Note: The TSP must provide the correct Taxpayer Identification Number (TIN) to the IRS on Form 1042-S. In the case of a payment to a nonresident alien participant, the participant's Individual Taxpayer Identification Number (ITIN) will be used. In the case of a U.S. citizen or resident alien participant, the participant's Social Security number (SSN) will be used. In the case of the death of a participant, if the beneficiary is a nonresident alien, the beneficiary's ITIN will be used; if the beneficiary is a U.S. citizen or resident alien, the beneficiary's

SSN will be used. If payment is made to a trust or estate, an executor, administrator, or trustee must furnish to the TSP a TIN for the trust or estate before payment will be made to that entity. An individual who applies to the TSP for payment under a state's small estate procedure must also furnish a TIN for the estate. Thus, a TIN must be furnished for a trust or estate, although there may be no need to file IRS Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.

A nonresident alien can obtain an ITIN by filing IRS Form W-7, Application for IRS Individual Taxpayer Identification Number. If you believe that you are entitled to a partial or complete refund of amounts withheld, file IRS Form 1040-NR, U.S. Nonresident Alien Income Tax Return, to claim such amounts.

If you are required to file a U.S. income tax return, you should include the amount reported on Form 1042-S as income on your individual income tax return for the year in which the payments were made. However, you should exclude from adjusted gross income on your return any amounts that were transferred or rolled over to an IRA of yours. If U.S. income tax was withheld, you should also attach a copy of Form 1042-S to your Federal tax return.

8. How can I contact the TSP Service Office?

All correspondence with the TSP Service Office that concerns a TSP payment described in this notice should be sent to the following address:

TSP Service Office
National Finance Center
P.O. Box 61500
New Orleans, LA 70161-1500

Include both your name and Social Security number and the name and Social Security number of the deceased participant (if applicable).